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No. 06-560

IN THE

Supreme Court of the United States

AVIS BUDGET GROUP, INC. a/k/a CENDANT CORPORATION, TIME WARNER INC., RICHARD A. SMITH, DAVID COLBURN and ERIC KELLER,

Petitioners,

v.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether *certiorari* should be denied in this case due to mootness and lack of standing because there is no current case pending against Petitioners since Respondent's motion for leave to amend to file an amended complaint was denied as to Petitioners, and that ruling is currently on appeal.

2. Whether a person may be primarily liable under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), for engaging in a "scheme to defraud," where that person engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in the furtherance of a scheme to defraud, and where the misconduct of the person satisfied all elements required for primary liability under Section 10(b). *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006) ("*Homestore*").

LIST OF PARTIES

As noted in the Petition, Defendant-Respondent MaxWorldwide, Inc., fka L90, Inc. did not join in the original Petition and is not a Petitioner.

Pursuant to Supreme Court Rule 29.6, California State Teachers' Retirement System states that it is a governmental agency pursuant to California Education Code Section 22000 *et seq.*; hence no corporate disclosure is required.

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STATEMENT OF JURISDICTION

On June 30, 2006, the Ninth Circuit Court of Appeals entered its judgment. On September 21, 2006, this Court extended the time to file this Petition to November 13, 2006. This Petition was then filed on October 21, 2006. On December 26, 2006, this Court extended the time within which to file a response to the Petition to February 7, 2007. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5(a), (b) and (c), promulgated thereunder, 17 C.F.R. § 240.10b-5.

§ 78j Manipulative and deceptive devices

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any national securities exchange –
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange, or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission

may prescribe as necessary or appropriate in the public interest for the protection of investors.

15 U.S.C. § 78j(b).

§ 2401.10b-5 Employment of Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility or any national securities exchange,

(a) To employ any device, scheme or artifice to defraud,

(b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

STATEMENT OF THE CASE

I. Factual Background And Allegations

Beginning in December 2001, class action complaints were filed against Homestore.com, Inc. ("Homestore"),[1] an internet company that provides real estate and home ownership services, and other individuals and entities on behalf of persons who purchased shares of Homestore common stock. The United States Court for the Central District of California consolidated these actions in a proceeding entitled *In re Homestore.com, Inc. Sec. Litig.*, Case No. CV 01-11115 MJP (the "Action") and approved the appointment of Respondent California State Teachers' Retirement System ("CalSTRS"), a pension fund for California's public school teachers, as Lead Plaintiff for the putative Class.

On November 15, 2002, Lead Plaintiff filed the operative First Amended Consolidated Complaint in the Action (the "Complaint") that alleges, among other things, that in an unlawful scheme to artificially inflate the value of Homestore common stock, Homestore's financial statements were materially misstated.

> Plaintiff alleges in its complaint that several Homestore insiders, with the knowledge of Homestore's auditor and the active participation of various outside business entities, unlawfully created revenue through various types of dubious transactions in order to prop up Homestore's stock price. Plaintiff claims that these transactions, combined with improper accounting and the release of written and oral public statements made to the SEC, analysts, and the general public, perpetrated a fraud on Homestore's shareholders and the investing

1. In 2006, Homestore.com, Inc. changed its name to Move, Inc., which can be found on the internet at *http://www.move.com.*

> public in violation of Federal securities statutes and regulations promulgated thereunder. Eventually, Homestore was forced to restate seven quarters of revenue because of the improper transactions and accounting. By this action, plaintiff seeks to recover damages incurred when the market price of Homestore common stock fell dramatically once the need for restatement became public.

Pet. App. 32a-33a.

The Complaint alleges that Homestore and Petitioners Cendant Corporation, Time Warner, Inc., Richard A. Smith, David Colburn, and Eric Keller, and Defendant L90, Inc. ("L90"), among other wrongful acts, engaged in improper transactions, including round-trip transactions. Pet. App. 41a-47a. The District Court summarized the allegations in the Complaint:

> Plaintiff alleges that America Online Time Warner ("AOL") was a major player in arranging many of the illicit revenue boosting transactions. AOL employees David Colburn and Eric Keller are also named as defendants for their roles as the primary Homestore contacts within AOL and the architects of many of the improper "round trip" transactions. Both were released by AOL under suspicion of certain illegal transactions with Homestore and other companies. Plaintiff does allege, however, that the transactions continued after the two individuals left, further implicating AOL in the scheme to defraud.
>
> Cendant Corporation ("Cendant") is a major player in the on-line real estate business, and has substantial activities in the car rental and travel industries as well. Plaintiff alleges that Cendant and its CEO Richard Smith engaged in "triangular" transactions

> between Homestore, Cendant and one of Cendant's subsidiaries. This transaction also represents a "related party" transaction that was not appropriately accounted for as such.
>
> L90 is a media company. Plaintiff alleges that L90 engaged in illegal "triangular" transactions and "barter" transactions with Homestore and third parties.

Pet. App. 37a.

The Complaint further alleges that Lead Plaintiff and the other members of the Class purchased or acquired Homestore common stock at prices that were artificially inflated as a result of the dissemination of Homestore's materially false and misleading financial statements in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78t, and Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated thereunder. Pet. App. 33a; 82a.

II. District Court Proceedings

In January 2003, Petitioners and other defendants moved to dismiss the Complaint on the grounds that the Complaint did not state a claim under Section 10(b). In an opinion and order dated March 7, 2003, the District Court dismissed with prejudice the claims against Petitioners and other defendants. The District Court concluded that the Complaint alleged aiding and abetting conduct which is insufficient to state a claim under Section 10(b) under this Court's ruling in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) ("*Central Bank*") because the Petitioners and L90 were alleged to have merely assisted the commission of a deceptive act. Pet. App. 81a. In making this ruling, the District Court stated:

> While this Court feels compelled to arrive at this result, it does so with reservation. The acts alleged

> in the FACC [the Complaint], which this Court must accept as true for purposes of this motion, describe a massive conspiracy driven by pure avarice. In particular, the detailed factual allegations describing the role of AOL and its agents in helping Homestore please Wall Street and in boosting its own revenues through bogus commissions give this Court great pause. Nevertheless, the role of AOL and the other business partner and third party vendor defendants appears to be exactly the role of aiders and abettors prior to *Central Bank*, and is exactly the role that *Central Bank* exempted from liability.

Pet. App. 81a (bracketed material added).

III. The Decision Below

Respondent CalSTRS appealed to the United States Court of Appeals for the Ninth Circuit. After reviewing the allegations in the Complaint, the Ninth Circuit concluded that: "Plaintiff's complaint insufficiently alleged that Defendants were primary violators of § 10(b) based on their conduct in the furtherance of the scheme." *Homestore*, 452 F.3d at 1043; Pet. App. 3a. Hence, the Ninth Circuit *affirmed* the District Court's dismissal of the Complaint, but r*emanded* to permit CalSTRS to seek leave to amend the complaint "if that can be done consistent with this opinion." *Id.* at 1055; Pet. App. 16a.

In its opinion, the Ninth Circuit followed this Court's holding in *Central Bank* that "§ 10(b) does not allow recovery for aiding and abetting liability" *Id.* at 1042; Pet. App. 3a citing *Central Bank*, 511 U.S. at 177-178. Since this Court in *Central Bank* did not fully define the scope of primary liability, *id.*, the Ninth Circuit relied upon the language of Section 10(b), this Court's precedents, and the Securities and Exchange Commission's ("SEC") test to determine if allegations that Petitioners engaged in a "scheme to defraud" to overstate the

revenues of Homestore stated a claim under Section 10(b). *Id.* at 1043; *see id.* at 1048; Pet. App. 3a; 15a-16a. The Ninth Circuit held that a defendant may be held primarily liable under Section 10(b) for a scheme to defraud if the defendant's *own conduct* had "the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." *Id.* at 1048 (emphasis added); Pet. App. 16a. Mere participation in a transaction that had a deceptive purpose and effect is insufficient for primary liability. *Id.* This test serves as "an aid to assessing whether the defendant's conduct was sufficiently deceptive for § 10(b) liability." *Id.* at 1048 n.5; Pet. App. 17a.[2]

The Ninth Circuit reasoned that, by itself, the *scienter* requirement cannot distinguish aiding and abetting from primary liability because while a defendant may intend to deceive the public by assisting another's misconduct as part of a scheme to defraud, the defendant may fail to engage in conduct that created a false appearance in furtherance of the fraudulent scheme. *Id.* Unlike the element of *scienter*, the examination of the "principal purpose and effect" of the defendant's conduct allows a court to differentiate aiding and abetting from conduct that constitutes a primary violation under Section 10(b). *Id.* The court clarified that

> [n]or is 'scheme to defraud' liability a substitute for aiding and abetting liability that the Supreme Court

2. In an *amicus curiae* brief in the proceedings below, the SEC proposed the following test for primary liability: "Any person who directly or indirectly engages in a manipulative or deceptive act as a part of a scheme of scheme to defraud can be a primary violator." The Ninth Circuit did not strictly follow the SEC's definition of "deceptive act" as "engaging in a transaction whose principal purpose and effect is to create a false appearance of revenues." The Ninth Circuit concluded that involvement in a transaction that had a deceptive purpose and effect was insufficient, and that the defendant's *own conduct* must have had a deceptive purpose *and* effect. *Homestore*, 452 F.3d at 1048; Pet. App. 15a to 16a.

> precludes in *Central Bank*. The focus of the inquiry on the defendant's own conduct ensures that only primary violators (that is, only defendants who use or employ a manipulative or deceptive device) are held liable under the Act.

Id. at 1049; Pet. App. 18a.

The Ninth Circuit concluded that conduct that meets these requirements may be considered "in connection with" the purchase or sale of securities if it is part of a scheme to misrepresent publicly reported financial information where the scheme will not be complete until the fraudulent information is introduced into the securities market. *Id.* at 1051; Pet. App. 21a. If several defendants used or employed a deceptive device in furtherance of a scheme to misrepresent financial information, then all such defendants may be viewed as having acted in connection with the purchase or sale of securities. *Id.*

Regarding the element of reliance, the Ninth Circuit held that the requirement is met if the introduction of misleading statements was the intended end result of a scheme to misrepresent financial information. *Id.* at 1051-1052; Pet. App. 21a-23a. The Ninth Circuit followed the fraud on the market presumption of reliance that this Court endorsed in *Basic v. Levinson*, 485 U.S. 224, 247 (1988).

In response to the decision below, on September 29, 2006, CalSTRS moved the District Court for leave to file a Second Amended Consolidated Complaint ("Amended Complaint"). The Amended Complaint contained numerous new allegations against each of the Petitioners, and L90, based on facts that became available only after the filing of the Complaint in November 2002. Such newly available facts came from discovery, testimony in the criminal trial of former Homestore

Chief Executive Officer Stuart Wolff,[3] and plea agreements (*e.g*, from Mark Roah and other senior executives of L90). Despite the substantial new allegations in the Amended Complaint, CalSTRS's motion for leave to file the proposed Amended Complaint was *denied* by Judge Ronald S.W. Lew on December 18, 2006 as to all Petitioners on the grounds that amendment would be futile. The motion for leave to amend was granted only as to L90. Respondent has filed an appeal from the ruling denying it leave to amend.

Accordingly, the Petitioners' claim that the Ninth Circuit's opinion "will serve as a portal for plaintiffs to bring a species of 'aiding and abetting' claims against secondary actors," Pet. at 27, is proved incorrect by virtue of the District Court's denial of Respondent's motion to file the Amended Complaint. Even though the Complaint was based on allegations from inside sources "who were most probably former executives at Homestore and therefore provide a unique insight not generally available to most private securities litigants" and "four former Homestore executives have pled guilty to various criminal charges," *Homestore*, 252 F. Supp. 2d at 1020; Pet. App. 33a, both the District Court and the Ninth Circuit found Respondent's allegations in the Complaint insufficient to state a claim. *Id.* at 1045, 452 F.3d at 1055; Pet. App. 90a, 30a to 31a.

SUMMARY OF ARGUMENT

As a threshold matter, the Petition should be denied on the grounds of mootness. On remand after the Ninth Circuit's opinion, the District Court denied Respondents' motion for leave to file an Amended Complaint and dismissed all the Petitioners

3. On June 22, 2006, Mr. Wolff was convicted on eighteen felony counts, including insider trading, filing false reports with the SEC, and conspiracy, for orchestrating a scheme to inflate Homestore's revenues in 2001 through round-trip transactions. C.D. Cal. Case No. CR 05-398 PA.

from the suit. Since Respondent has appealed the District Court's order denying leave to amend and there is no case pending against Petitioners, this Court should not grant the Petition.

The Ninth Circuit followed the language of Section 10(b) and this Court's holding in *Central Bank*, 511 U.S. at 164 that there is no aiding and abetting liability under Section 10(b) when it determined that the allegations in Respondent's Complaint did not meet the requirements for primary liability under subparts (a) and (c) of Rule 10b-5. The decision below is also supported by decisions of this Court, and is consistent with other courts of appeals that have addressed the same issue.

Despite this lack of conflict, Petitioners' Petition rests on three grounds. First, Petitioners claim that the decision below conflicts with four other circuit courts. Second, Petitioners argue that the decision below is in conflict with *Central Bank*. Third, Petitioners claim that certiorari should be granted for policy reasons.

None of the Petitioners' claims has merit. The first claim is based on an incomplete reading of the decision below and this Court's precedents. The second claim does not recognize this Court's decisions regarding the distinction in claims under different subparts of Rule 10b-5. The policy reasons lack merit because the opinion does not provide a "portal for plaintiffs to bring a species of 'aiding and abetting' claims", Pet. at 27. As demonstrated by the lower courts' rulings that Respondent's allegations were insufficient, even though there were detailed facts concerning the fraud, information supplied by insiders of the company and criminal pleas, the Ninth Circuit's standard for pleading a primary liability claim under Section 10(b) is high. Review of the decision below is therefore unwarranted.

REASONS FOR DENYING THE PETITION

I. The Petition Should Be Denied On The Grounds Of Mootness

The Petition should be denied because it is moot. This Court stated in *North Carolina v. Rice*, 404 U.S. 244, 246 (1971) that "it has frequently been repeated that federal courts are without power to decide questions that cannot affect the rights of litigants in the case before them." This Court explained that "a case is moot when the issues presented are no longer 'live' or the parties lack a legally cognizable interest in the outcome." *City of Erie v. Pap's A.M.*, 529 U.S. 277, 287 (2000). The existence of a concrete and definite controversy is a Constitutional requirement for judicial review. *Rice*, 404 U.S. at 246.

Here, the issues raised by the Petition are moot. On December 18, 2006, the District Court denied Plaintiff-Respondent's motion for leave to file an Amended Complaint as against the Petitioners on the grounds that amendment would be futile under the decision below. Respondent is currently appealing that order.[4]

None of the Petitioners has a legal interest in the issue presented by the Petition because they have all been dismissed from the suit. There is no live controversy, and all questions raised by the Petition are moot. Because "moot questions require no answer," *Missouri, Kansas & Texas R. Co v. Ferris*, 179 U.S. 602, 606 (1900), the Petition should be denied.

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4. The District Court allowed Respondent to file the amended complaint against L90, who is not a Petitioner in this Petition.

II. The Decision Below Comports With This Court's Precedents Regarding Liability Under Section 10(b)

A. This Court in *Central Bank* Did Not Address the Issue of Primary Liability under Section 10(b) for a Scheme to Defraud

This Court in *Central Bank* granted *certiorari* "to resolve the continuing confusion over the existence and scope of the § 10(b) aiding and abetting action." *Id.* at 170. As stated by the Ninth Circuit in this case: "The Supreme Court held in *Central Bank* that § 10(b) does not allow recovery for aiding and abetting liability, . . ." *Homestore*, 452 F.3d at 1042; Pet. App. 3a citing *Central Bank*, 511 U.S. at 191.

While *Central Bank* addressed the viability of the aiding and abetting action, it did not fully define the scope of primary liability under Section 10(b), *Homestore*, 452 F.3d at 1043; Pet.App. 3a, or address whether a scheme to defraud could satisfy the requirements of primary liability, the issue before the Ninth Circuit. *Id.* at 1048; Pet. App. 15a. To the extent that the decision below involved a different issue from *Central Bank*, it does not conflict with *Central Bank.*

Petitioners attempt to create a conflict by asserting that the only conduct which violates Section 10(b) is "the making of a material misstatement (or omission) or the commission of a manipulative act." Pet. at 15. In support of their argument, Petitioners rely upon the following statement from *Central Bank:* "As in earlier cases considering conduct prohibited by 10(b), we again conclude that the statute prohibits *only* the making of material misstatement (or omission) or the commission of a manipulative act." Pet. at 15 citing 511 U.S. at 177 (emphasis added by Petitioners).

The issue of scheme liability, however, was not before the Court in *Central Bank*. As the SEC pointed out, in the proceedings below, this statement "was not necessary for the

Supreme Court, in deciding that aiding and abetting is not covered by the statutory language, to determine the full extent of deceptive conduct covered by Section 10(b) – an issue not raised by the case or briefed by the parties." SEC *Amicus Curiae* Reply Brief at 2 to 3. Accordingly, there is no conflict between the Ninth Circuit's decision and *Central Bank*.

Nor is there a prohibition under Section 10(b) for liability arising from a scheme to defraud. This Court has emphasized on numerous occasions that Section 10(b) "should be 'construed not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *See e.g. SEC v. Zandford*, 535 U.S. 813, 819 (2002) quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. at 128, 151 (1972). This Court has also recognized that Section 10(b) prohibits all fraudulent schemes:

> [We do not] think it sound to dismiss a complaint merely because the alleged scheme does not involve the type of fraud that is 'usually associated with the sale or purchase of securities.' We believe that § 10(b) and Rule 10b-5 prohibit *all fraudulent schemes* in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.

Superintendent of Ins. of New York v. Bankers Life, 404 U.S. 6, 11 n.7 (1971) quoting *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2nd 1967) (emphasis in original and added; internal citation omitted). The proscriptions in Section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are *obviously meant to be inclusive*." *Affiliated Ute*, 406 U.S. at 151 (emphasis added).

B. The Ninth Circuit Decision Follows the Language of Section 10(b) and this Court's Precedents

Section 10(b) of the Securities Exchange Act of 1934 prohibits (1) the "use or employ[ment] . . . of any . . . deceptive device or contrivance"; (2) by "any person"; (3) "in connection with the purchase or sale of any security"; and (4) "in contravention of" Securities and Exchange Commission "rules and regulations." 15 U.S.C. § 78j(b) (bracketed material added).

This Court has defined "device" to include a "scheme" and a "scheme to deceive." Regarding the scope of Section 10(b), this Court addressed the meaning of "device" and "contrivance" in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), which Petitioners cite for the proposition that Section 10(b) prohibits only conduct that is "manipulative or deceptive" within the meaning of the statute. Pet. at 14 citing *Hochfelder*, 425 U.S. at 213-214. In reference to the term "device," this Court in *Hochfelder* refers to the Webster's International Dictionary (2d ed. 1934) for the definition of "device" as "[t]hat which is devised, or formed by design; a contrivance; an invention; project; *scheme; often, a scheme to deceive . . .*" *Id.* at 199 n.20 (emphasis added); *see also Homestore*, 452 F.3d at 1047; Pet.App. at 13a-14a. Since this Court has defined a "device" as a scheme or scheme to deceive, a "scheme to defraud" theory of liability falls within this Court's interpretation of the scope of Section 10(b) liability.[5] This definition of "device" is consistent with the remedial purposes of the statute.

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5. *Chiarella v. United States*, 445 U.S. 222, 236 (1980) does not stand for the broad proposition, as Petitioners claim, Pet. at 14-15, that "deceptive" conduct only includes "the common law categories of a misrepresentation or an omission if there is a duty to disclose." The question before this Court in *Chiarella* was "whether a person who learns from the confidential documents of one corporation that it is planning an attempt to secure control of a second corporation violates

(Cont'd)

The language of Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated by the SEC is also instructive. As this Court has explained, "[t]he scope of Rule 10b-5 is coextensive with the coverage of § 10(b), see *United States v. O'Hagan*, 521 U.S. 642, 651 (1997); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976)." *Zandford*, 535 U.S. at 816 n.1.

Rule 10b-5 contains three subparts, (a), (b) and (c) that prohibit certain actions in connection with the purchase or sale of any security. The three subparts of Rule 10b-5 are enumerated in the disjunctive, as the "or" after subpart (b) makes clear. Rule 10b-5(b) makes it unlawful "[t]o make any untrue statement of a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading." 17 C.F.R. § 240.10b-5 (1976). Subparts (a) and (c) of Rule 10b-5 respectively prohibit the use of "any device, practice, *or* artifice to defraud," or "any act, practice, *or* course of business which operates *or* would operate as a fraud *or* deceit upon any person." *Id.* (Emphasis added).

While subpart (b) prohibits the making of misrepresentations and omissions, the inclusion of the words "any" and "or" in subparts (a) and (c) clearly demonstrates that Section 10(b) and Rule 10b-5 forbid methods other than misrepresentations and omissions that may be used to defraud investors.

Section 17(a) of the Securities Act of 1933, which makes unlawful fraudulent interstate transactions, is analogous to Rule 10b-5 in that the disjunctive language "or" is present in both of

(Cont'd)

§ 10 (b) of the Securities Exchange Act of 1934 if he fails to disclose the impending takeover before trading in the target company's securities." *Id.* at 224. This Court held that the conduct did not violate Section 10(b): "When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak. We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.* at 235.

them, and an infinitive is used to introduce each of the three subparts. In construing Section 17(a), this Court concluded that "each subsection proscribes a distinct category of misconduct. Each succeeding prohibition is meant to cover additional kinds of illegalities – not to narrow the reach of the prior sections." *United States v. Naftalin*, 441 U.S. 768, 774 (1979) citing *United States v. Birrell*, 266 F. Supp. 539, 542 (S.D.N.Y. 1967). Based upon the same disjunctive language in both Section 17(a) and Rule 10b-5, the analysis of this Court in *Naftalin*, should apply to Rule 10b-5.

While the vast majority of private actions alleging Rule 10b-5 violations concern misrepresentations or omissions, or conduct prohibited by subpart (b) of Rule 10b-5, *see In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 497 (S.D.N.Y. 2005), subparts (a) and (c) are also subparts of Rule 10b-5 whose violation gives rise to liability. Failure to give effect to subparts (a) and (c) would render them mere surplusage, in contravention of the canon of statutory interpretation requiring a court to give effect to each word of a statute if possible. *See Alaska Dep't. of Envtl. Conservation v. E.P.A.*, 540 U.S. 461 (2004) (this Court recognized cardinal principle that a statute ought to be construed to prevent any clause, sentence, or word from being rendered superfluous, void, or insignificant); *Duncan v. Walker*, 533 U.S. 167 (2001) (this Court reluctant to treat statutory terms as surplusage in any setting). As a result, subparts (a) and (c) cannot be ignored or written out of the statute, since those subparts were neither inadvertently inserted nor in conflict with the rest of Section 10(b) or Rule 10b-5. The language of subparts (a) and (c) of Rule 10b-5 must be given effect.

Petitioners claim that there is no decision in which this Court has found Section 10(b) liability absent manipulation or deception within the meaning of the statute. Pet. at 14, 15 n.5. However, consistent with this Court's recognition of the distinction in claims under Rule 10b-5(b) versus claims under

Rule 10b-5(a) and (c), this Court has stated that Section 10(b) reaches deceptive "practices," *Santa Fe Ind., Inc. v. Green*, 430 U.S. 462, 475-476 (1977), deceptive "conduct," *id.* at 475 n.15; *O'Hagan*, 521 U.S. at 659, and deceptive "acts," *Central Bank*, 511 U.S. at 173; *see Bankers Life*, 404 U.S. at 9. Reaffirming this interpretation of Section 10(b), this Court recently stated that Rule 10b-5 forbids more than just misrepresentations and omissions: "Commission Rule 10b-5 forbids, *among other things*, the making of 'any untrue statement of material fact' or the omission of any material fact 'necessary in order to make the statements made . . . not misleading.'" 17 CFR § 240.10b-5 (2004)." *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 340 (2005) (emphasis added).

Reading Rule 10b-5 as restrictively as Petitioners suggest, to include only misrepresentations and omissions, conflicts with this Court's interpretation of Section 10(b) and Rule 10b-5, and would eviscerate subparts (a) and (c). There is no justification for this interpretation. This Court should decline Petitioners' invitation to excise subparts (a) and (c) from Rule 10b-5 and deny the Petition.

Applying these principles, the Ninth Circuit considered whether the Complaint stated a claim under Section 10(b) based upon allegations of a scheme to defraud. *Homestore*, 452 F.3d at 1048; Pet. App. at 15a. Its opinion falls squarely within the language of Section 10(b) and this Court's precedent in holding that there can be liability for violation of Section 10(b) based upon a scheme to defraud, if all the other elements of Section 10(b) are satisfied. *Id.* at 1043; *see id.* at 1048; Pet. App. 3a; 15a-16a.

III. The Decisions Of Other Circuits Do Not Provide A Basis For This Court To Grant Certiorari In This Case

Petitioners seek review in this cased based upon their claim of a conflict with *Shapiro v. Cantor*, 123 F.3d 717 (2nd Cir 1977), *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215 (10th Cir. 1996), and *Ziemba v. Cascade Int'l., Inc.*, 256 F.3d 1194 (11th Cir. 2001). Because these cases all involved misrepresentations or omissions, which are considered under Rule 10b-5(b), none of these three Courts of Appeals had the occasion to discuss the distinction in the claims under different subparts of Rule 10b-5. *See Shapiro*, 123 F.3d at 719;[6] *Anixter*, 77 F.3d at 1226; *Ziemba*, 256 F.3d at 1203, 1206.

In contrast, the Ninth Circuit expressly noted that Rule 10b-5(b) concerns misstatements or omissions, while Rule 10b-5(a) and (c) concern fraudulent schemes. *Homestore*, 452 F.3d at

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6. Petitioners make much of the Second Circuit's statement that to be held primarily liable under Section 10(b), "a defendant must actually make a false or misleading statement." *Shapiro*, 123 F.3d 717, 720; Pet. at 13. However, the District Court in *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 503 (S.D.N.Y. 2005), astutely noted that

> [t]he Second Circuit has made clear that to 'make' a statement for purposes of *Rule 10b-5(b)* requires that the statement must be attributed to its maker at the time it was made. That is a *different matter* from whether a defendant's challenged conduct in relation to a *fraudulent scheme* constitutes the use of deceptive device or contrivance.

(Emphasis added). Distinguishing between misstatements and deceptive devices in this way comports with this Court's decisions that recognize the distinction between claims under subparts (a) and (c) and claims under subpart (b) of Rule 10b-5. This analysis indicates that *Shapiro* is properly understood as limited in its applicability to Rule 10b-5(b). Accordingly, the decision below does not directly conflict with *Shapiro* because the decisions considered primary liability under different subparts of Rule 10b-5. *Anixter* and *Ziemba* are not in conflict with the Ninth Circuit for the same reason.

1046; Pet. App. 11a. The issue before the Ninth Circuit was "what conduct constitutes a manipulative or deceptive act in the furtherance of a scheme to defraud sufficient to render the defendant a 'primary violator' of § 10(b)?" *Id.* at 1048; Pet. App. 15a. Petitioners agree that the Ninth Circuit stated that it considered the sufficiency of the allegations regarding the use or employment of a deceptive device or contrivance by the Defendants, not liability based on actionable omissions or manipulation, because of the specific allegations in the Complaint. *Id.* at 1047 n.2; Pet. 13a. Thus, the decision below logically is focused on primary liability under subparts (a) and (c) of Rule 10b-5, which address primary liability for schemes to defraud.

Petitioners also assert that the decision below conflicts with the Eighth Circuit's decision in *In re Charter Communications, Inc. Sec. Litig.*, 443 F.3d 987 (8th Cir. 2006), *petition for cert. filed*, 75 U.S.L.W. 3034 (U.S. July 7, 2006) (No. 06-43). Pet. at 7. Yet, unmentioned by Petitioners is the fact that the Ninth Circuit specifically cited and followed *Charter*:

> Participation in a legitimate transaction, which does not have a deceptive purpose or effect, would not allow for a primary violation even if the defendant knew or intended that another party would manipulate the transaction to effectuate a fraud. See *In re Charter Commc'ns, Inc., Sec. Litig.*, 443 F.3d 987, 992 (8th Cir. 2006) (refusing to impose primary liability 'on a business that entered into an arm's length non-securities transaction with an entity that then used the transaction to publish false and misleading statements to its investors and analysts)[.]

Homestore, 452 F.3d at 1050; Pet. App. at 19a (bracketed material added).

In *Charter*, "Plaintiffs alleged that the Vendors entered into these sham transactions knowing that Charter intended to account for them improperly and that analysts would rely on the inflated revenues and operating cash flow in making stock recommendations." *Charter*, 443 F.3d at 991. The Eighth Circuit stated: "The Court can find no precedent for the conclusion that business partners, such as [the Vendors], made false and misleading statements by virtue of engaging in a business enterprise with a company such as Charter, the entity purported to have made the statement at issue." *Id.* at 991. The fact that the business partners may have known that the transactions would be used to mislead investors is insufficient to impose liability. *Id.* at 992-993.

Similarly in *Homestore*, the Ninth Circuit held that Respondent's allegations were insufficient to impose liability. As to AOL, the Ninth Circuit concluded:

> It is not alleged that AOL or its officers created sham business entities or engaged in deceptive conduct as part of illegitimate transactions, . . . There is no indication from the FACC that the transactions engaged in by AOL were completely illegitimate or in themselves created a false appearance . . . [I]t may not be liable for participating in legitimate transactions that became 'deceptive' only when distorted by the willful or intentional fraud of another party.

Homestore, 452 F.3d at 1052, 1053; Pet. App. at 25a, 26a (bracketed material added). For Cendant, the Ninth Circuit stated:

> We agree that the FACC [the Complaint] does not indicate how these transactions involving Cendant created a false appearance, independent from

> Homestore's misreporting of the income from these transactions as unrelated to any previous transaction . . . [T]he FACC does not allege that Cendant's specific actions in these transactions created a false appearance independent of the improper accounting by Homestore.

Id. at 1053, 1054; Pet.App. at 27a, 28a (bracketed material added).

Petitioners make much of supposed differences in the wording of these circuits' standards, but without showing that they differ in practical effect. Indeed, both the Eighth and Ninth Circuits found that business partners do not violate Section 10(b) for legitimate transactions that became deceptive only by the wilful misstatements of another party. *Charter*, 443 F.3d at 992; *Homestore*, 452 F.3d at 1050 (citing *Charter*, 443 F.3d at 992); Pet. App. 19a. Accordingly, if the Eighth and Ninth Circuits would reach the same conclusion regarding these allegations, the purported conflict is illusory and without practical effect.

In summary, review of the Ninth Circuit's decision based upon its alleged differences with other circuits is unwarranted, especially in light of the fact that Respondent currently has no case pending against Petitioners because its Complaint was dismissed and it was not allowed leave to amend to file an amended complaint against Petitioners.

IV. The Decision Below Properly Defined The Pleading Requirements For A Scheme To Defraud Under Section 10(b)

A. This Court Has Recognized The Distinction Between Claims Under Rule 10b-5(b) and Rule 10b-5(a) and (c)

This Court recognized the distinction between claims under Rule 10b-5(b) and Rule 10b-5(a) and (c) in *Affiliated Ute*, 406 U.S. at 128. Upon reviewing the Tenth Circuit's reading of Rule 10b-5 to require a misrepresentation (or omission), this Court concluded:

> [T]he Court of Appeals erred when it held that there was no violation of the Rule [10b-5] unless the record disclosed evidence of reliance on material fact misrepresentations by Gale and Haslem. We do not read Rule 10b-5 so restrictively. To be sure, the second subparagraph of the rule specifies the making of an untrue statement of a material fact and the omission to state a material fact. *The first and third subparagraphs are not so restricted.*

Id. at 152-153 (internal citations omitted; brackets and emphasis added). This Court therefore requires that a claim under Rule 10b-5(b) show a misrepresentation or omission, while a claim under 10b-5(a) or (c) need not.

The Southern District of New York's recent review of this Court's decisions reached the same conclusion regarding claims under Rule 10b-5(a) and (c):

> It is apparent from Rule 10b-5's language and the caselaw interpreting it that a cause of action exists under subsections (a) and (c) for behavior that constitutes participation in a fraudulent scheme, *even*

> *absent a fraudulent statement by the defendant.* See *Affiliated Ute*, 406 U.S. at 152-53; *SEC v. Zandford*, 535 U.S. at 820 ("Neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act.") . . . Claims for engaging in a fraudulent scheme and for making a fraudulent statement or omissions are thus distinct claims, with distinct elements.

In re Global Crossing, Ltd. Sec. Litig., 322 F. Supp. 2d 319, 335-336 (S.D.N.Y. 2004) (emphasis added).

Consistent with this Court's decisions, numerous district courts have applied the distinction in claims for violations of subpart (b) of Rule 10b-5 versus claims for violations of subparts (a) and (c). District courts in the Second Circuit (*e.g.*, *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 491-492 (S.D.N.Y. 2005)); Third Circuit (*e.g.*, *In re PNC Fin. Servs. Group, Inc., Sec. Litig.*, 440 F. Supp. 2d 421, 434 (W.D. Pa. 2006)); Fourth Circuit (*e.g.*, *In re Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 372 (D. Md. 2004)); and Sixth Circuit (*e.g.*, *In re CMS Energy Sec. Litig*, 2005 U.S. Dist. LEXIS 439 at *20 (E.D. Mich. Jan. 7, 2005)) have recognized this distinction in claims for violations of subpart (b) of Rule 10b-5 versus claims for violations of subparts (a) and (c).

Similarly, district courts have recognized a "scheme to defraud" theory of liability similar to that of the decision below. *See In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 172 (D. Mass. 2003) (denying a motion to dismiss brought by business partners who invented sham corporate entities that allowed a corporation "to hide research and development expenses, create fictitious revenue, and ultimately overstate profits in financial reports"); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-337 (S.D.N.Y. 2004) (permitting

claims of primary liability to proceed where auditors "masterminded" the company's deceptive accounting practices). These district courts followed this Court's explicit recognition that the elements of claims under subparts (a) and (c) of Rule 10b-5, which concern fraudulent schemes, differ from the elements of claims under subpart (b).

B. The Decision Below Prohibits Primary Liability Under Section 10(b) For Aiding And Abetting a Scheme to Defraud

Petitioners' argument that the decision below imposes primary liability for aiding and abetting turns on agglomerating claims for misstatements and omissions and claims for fraudulent schemes. Petitioners' attempt to graft aiding and abetting liability into the decision below is unavailing for two reasons.

First, *Central Bank* acknowledges that indirect proscribed activity is distinguishable from aiding and abetting activity. *Central Bank* observed:

> The federal courts have not relied on the 'directly or indirectly' language when imposing aiding and abetting liability under § 10(b), and with good reason . . . The problem, of course, is that aiding and abetting liability extends beyond persons who engage, even indirectly, in a proscribed activity; aiding and abetting liability reaches persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do.

511 U.S. at 176. This statement indicates that indirectly using a "manipulative or deceptive device or contrivance" under Section 10(b), which involves engaging in prohibited conduct, has a different scope from aiding and abetting, which does not involve engaging in prohibited conduct. The statement also indicates

that an actor in a scheme to defraud can be a primary violator if that actor indirectly engages in manipulative or deceptive conduct.

According to the decision below, a secondary actor in a scheme to defraud can be primarily liable by directly or indirectly engaging in a deceptive act. *Homestore*, 452 F.3d at 1049; Pet. App. 17a to 18a. While asserting that the decision below permits aiding and abetting liability, Pet. at 18 to 20, Petitioners ignore that the decision below requires that "the defendant's *own conduct* contributing to the transaction or overall scheme must have had a deceptive purpose and effect." *Id.* at 1048; Pet. App. 16a (emphasis in original). The Ninth Circuit explains that "[u]nlike the scienter requirement, the 'purpose and effect' test is focused on *differentiating* conduct that may form the basis of a primary violation under § 10(b) from *mere aiding and abetting activity* that the Supreme Court has held does not constitute a primary violation." *Id.* at 1048 n.5; Pet. App. 17a (emphasis added). Aiding and abetting does not satisfy the Ninth Circuit or SEC test of primary liability. *Id.* at 1049; Pet. App. 18a.

Second, Section 10(b) and Rule 10b-5 both provide that "any person" may be held liable for violating the statute. This Court has stated that the "repeated use of the word 'any' in the statute and the rule is obviously meant to be inclusive." *Affiliated Ute*, 406 U.S. at 151. *Central Bank* recognized that "[s]ome of the express causes of action [in the 1933 and 1934 Securities Acts] specify categories of defendants who may be liable; others (like § 10(b)) state only that 'any person' who commits one of the prohibited acts may be held liable." 511 U.S. at 179 (bracketed material added; parentheses in original). Thus, the statute does not limit liability to specific types of actors, and the focus is not on who the actor is, but what the actor did.

C. The Decision Below Retains The Requirement Of Reliance

Petitioners contend that the decision below dispenses with the requirement of reliance. Not true. Following this Court's precedent, the Ninth Circuit concluded that the requirement of reliance is satisfied if a misrepresentation was introduced into the securities market as a result of the fraudulent scheme and defendant's conduct therein. *Homestore*, 452 F.3d at 1052. In reaching this conclusion, the decision below pointed to this Court's express endorsement of the fraud on the market presumption of reliance in *Basic v. Levinson*, 485 U.S. at 224. In *Basic*, this Court explained that the fraud on the market theory proposes that, in an open, developed and impersonal securities market, the price of a company's stock reflects the available material information on the company and its business. *Id.* at 241. Under the fraud on the market presumption, "[t]he causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations," *id.* at 242, and "the reliance of individual plaintiffs on the integrity of the market *may be presumed*." *Id.* at 247 (emphasis added). As in *Basic*, the decision below concerned a fraud on the market where defendants' fraud did not involve direct misrepresentations.

Consistent with *Basic*, the decision below stated that the presumption is rebuttable in the absence of persuasive conflicting evidence. *Homestore*, 452 F.3d at 1052; *Basic*, 485 U.S. at 248 and 249 (defendants may rebut proof of the elements giving rise to the presumption). The decision below is therefore consistent with this Court's precedent regarding reliance.

D. The Decision Below Only Permits Liability For Conduct That Is Properly Viewed As "In Connection With" The Purchase Or Sale of Securities

Petitioners incorrectly claim that the decision below permits liability against secondary actors for conduct that cannot be seen as having occurred "in connection with" the purchase or sale of any security. Pet. at 23-26. Specifically, Petitioners argue that the decision below permits the "in connection with" requirement to be satisfied based solely on the later conduct of the issuer defendant. Pet. at 25.

The Ninth Circuit, however, stated that: "If multiple participants used or employed a deceptive device in furtherance of a scheme to misrepresent the reported revenues of a company, then all participants may be viewed as having acted in connection with the purchase or sale of securities." *Homestore*, 452 F.3d at 1051; Pet. App. 21a. Each defendant's conduct must be viewed alone to determine if it satisfied these requirements. *Id.* at 1050; Pet. App. 20a. Thus, the decision below comports with *Central Bank's* requirement that the conduct of each actor independently satisfy *each element* of a violation of Section 10(b). *Central Bank*, 511 U.S. at 191. The decision below does not involve "group" liability, but focuses on *each* defendant's conduct as part of the scheme to defraud, which scheme is consummated when the fraudulent information enters the securities market.

The Ninth Circuit properly cited to *Zandford*, 535 U.S. at 813 for the proposition that a scheme to misrepresent revenue may coincide with purchase or sale of a security because the scheme will not be complete until the fraudulent information is introduced into the securities market. *See* Pet. at 17 and 18. While characterizing *Zandford* as a Section 10(b) omission case involving a fiduciary, Petitioners fail to mention that *Zandford* described the alleged misconduct as intended to "further

respondent's fraudulent scheme," 535 U.S. at 820; "a fraud," *id.* at 821; and a "'course of business' that operated as a fraud or deceit . . . ," *id.* Following *Zandford*, where, as part of a scheme to misrepresent revenue, a defendant engages in a transaction whose principal purpose and effect is to create a false appearance of revenue, and where that effect continues at the time of purchases and sales of the company's stock, the fraud and the securities transactions in fact coincide. *See* SEC *Amicus Curiae* Reply Brief at 16 n.8. Because like *Zandford*, 535 U.S. at 822, the decision below requires that the scheme to defraud and the sale of securities coincide, it maintains the "in connection with" requirement for primary liability.

Moreover, the decision below is consistent with other courts, which have interpreted the "in connection with" requirement elaborated in *Bankers Life*, 404 U.S. at 12-13 to require "some nexus but not necessarily a direct and close relationship" between the fraud and the purchase or sale of a security. *Abrams v. Oppenheimer Gov't Sec., Inc.*, 737 F.2d 582 (7th Cir. 1984). The decision below is also consistent with *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860 (2d Cir. 1968), *cert. denied sub nom., Coates v. SEC*, 394 U.S. 976 (1969), where the Second Circuit stated that the fraudulent device need not be employed at the same time as the sale of a security: "Congress when it used the phrase 'in connection with the purchase or sale of any security' intended only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, cause them to purchase or sell a corporation's securities." *Id.* at 860. Thus, because the "in connection with" requirement does not require that the scheme to defraud occur simultaneously with the sale of securities, the decision below properly maintains the "in connection with" requirement.

V. The Decision Below Promotes Predictability And Certainty

The Petition should be denied for two further reasons. First, the decision below promotes predictability and certainty because it is consistent with *Central Bank* and other precedents regarding primary liability. By applying the requirements for primary liability to subparts (a) and (c) of Rule 10b-5, the decision below promotes predictability and certainty with respect to primary violator liability under Section 10(b) and Rule 10b-5.

The decision of the Ninth Circuit does not create a "portal for plaintiffs to bring a species of 'aiding and abetting claims'" as Petitioners claim. Pet. at 27. The examples offered by Petitioners would all be held insufficient to bring a Section 10(b) claim by the Ninth Circuit and the four other Courts of Appeals relied upon by Petitioners (*e.g.*, a company enters into a transaction knowing that the other party will improperly account for it). Thus, any purported conflict is inconsequential, and the decision below promotes predictable and certain outcomes.

Second, the decision below imposes a high hurdle for pleading primary liability. Petitioners claim that it would permit Section 10(b)/Rule 10b-5 claims to proceed against any company "merely because they engaged in significant business transactions with issuers who allegedly accounted for the transactions fraudulently on their own books." Pet. at 29. Yet, such conduct would certainly not meet the test of the decision below. The plaintiff must plead with sufficient particularity that the company engaged in conduct with the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme to defraud, and must meet all the elements of a Section 10(b) claim. The decision below makes clear that knowledge that the issuer would account for the transaction improperly *and* conduct that is consistent with the defendant's

normal course of business are *both* insufficient to state a claim under Section 10(b). *Homestore*, 452 F.3d at 1050; Pet. App. 19a.

After reviewing the allegations of the Complaint, the Ninth Circuit affirmed the District Court's dismissal because it found that the allegations were insufficient to show that Petitioners' and L90's conduct had the purpose and effect of creating a false appearance in fraudulent transactions that were part of a scheme to defraud. *Id.* at 1055; Pet. App. 28a.

In addition, to sufficiently state a primary violation, a plaintiff alleging a Section 10(b)/Rule 10b-5 violation in the Ninth Circuit must plead scienter with "particular facts giving rise to a strong inference of deliberate or conscious recklessness," *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 979 (9th Cir. 1999), an extremely stringent pleading standard. Considered together with the heightened pleading standards of Federal Rule of Civil Procedure Rule 9(b) and the Private Securities Litigation Reform Act of 1995, the decision below does not expand the scope of primary liability under Section 10(b).

CONCLUSION

For these reasons, the Petition for writ of certiorari should be denied.

Respectfully submitted,

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